



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

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Uniform Issue List: 408.01-00

SET:EP:RA:T3

LEGEND:

Decedent A =

Taxpayer B =

Taxpayer C =

Trust D =

State W =

City X =

Date L =

Date M =

Date N =

Date Q =

Date R =

Date S =

IRA X =

Court P:

Court Q =

Commissioner Z:

Statute Y:

Statute Z:

Statute AA:

Statute BB:

Dear , :

This is in response to your request for a private letter ruling, submitted by your authorized representative by letter dated , concerning the proper rollover treatment of distributions from Decedent A's individual retirement Account (IRA X) under section 408(d)(3) of the Internal Revenue Code (Code). This letter also considers subsequence correspondence submitted by your authorized representative on your behalf including correspondence dated , and .

Your authorized representative has submitted the following facts and representations in support of your ruling request:

Decedent A was born on Date L, 1929, and died on Date M, 2004 at age 75, a resident of State W. Taxpayer B, whose date of birth was Date Q, 1927, was married to Decedent A at the time of his death and survived Decedent A. Decedent A maintained an individual retirement account ("IRA"), IRA X, at the time of his death. Taxpayer C, Decedent A's son, also survived him.

Trust D was executed on Date N, 1996. Article IX of Trust T provides that Trust D shall be administered in accordance with the laws of State W. On Date R, 2000, Decedent A named Trust D as the beneficiary of his IRA X.

Pursuant to applicable provisions of Trust D, Taxpayer B is the sole trustee of Trust D. Pursuant to Article VI of Trust D, as sole trustee, Taxpayer B has authority and control over Trust D assets

Article IV(A) Trust D provides, in the event that Taxpayer B survives Decedent A (as was the case), the Trust D Trustee shall pay to Decedent A's surviving spouse as much of the income and, if the income is insufficient, as much of the principal as the Trustee considers advisable for her maintenance, support and health. Any income not distributed shall be added to principal.

Under Article IV(B), at Taxpayer B's death, the remaining principal shall be distributed to Decedent A and Taxpayer C, if living; or, if not, to Taxpayer C's then living descendants, per

stirpes; or, if neither Taxpayer C nor any of his descendants are then living, in equal shares to the then living nieces and nephews of Decedent A and Taxpayer B. Before making discretionary payments to Taxpayer B, the trustee shall consider the other financial resources available to Taxpayer B.

Article V(A) of Trust D provides, generally, that although the Trustee of Trust D shall consider other financial resources available to Taxpayer B before making discretionary payments to her, said Trustee is not limited to making such discretionary payments only when other financial resources are exhausted or substantially depleted.

Article V(B) contains a "spendthrift" clause which provides that persons with beneficial interests in property held by the trustee shall have no power to assign or anticipate their interests.

Article VI (F) of Trust D gives Taxpayer B, as the sole Trustee of Trust D, the authority "To exercise any other powers which the Trustee considers advisable for the proper and advantageous management, investment and distributions of the property held in the Trust".

Taxpayer B's authorized representative has argued on her behalf that the laws of State W permit the Trustee of Trust D, in the exercise of her discretion granted under the provisions of Trust D, to withdraw any, or all, of the Trust D principal if such withdrawal is advisable for her maintenance, support and health.

Taxpayer B's authorized representative has also directed the Service's attention to the following State W Statute:

Statute Y which provides, in general, that a Trustee may file with Commissioner Z of State W a statement that the person (Trustee) elects to have this section apply to all fiduciary assets controlled by the person.

A person who files the election referenced above becomes subject to the following section of the State W Statutes (among others): Statute Z which provides that in making an investment decision, the fiduciary may consider, without limitation, (iii) the expected tax consequences of investment decisions or strategies.

Statute AA of State W provides that to the extent any provision of Statute BB of State W is inconsistent with the terms of a governing instrument, the governing instrument shall control.

Documentation submitted to the Service indicates that the Trustee of Trust D has filed the election provided in Statute Y with Commissioner Z.

A controversy arose among Taxpayer B and Taxpayer C and Taxpayer B's and Decedent A's nephews and nieces. Taxpayer C and the nephews and nieces took the position that Taxpayer B,

as trustee of Trust D, did not have the discretion to withdraw the IRA X balance. Taxpayer B petitioned Court P of State W for a declaratory judgment that Taxpayer B has the discretion, as trustee of Trust D, to withdraw the balance from IRA X, and then to distribute the balance to Taxpayer B, individually, in order for her to contribute the balance into an IRA set up and maintained in her name. Taxpayer C and thirteen living nephews and nieces of Taxpayer B and Decedent A were defendants in this case. On Date S, 2007, the Court P ordered that Taxpayer B, as trustee of Trust D, has the discretion to withdraw the balance from IRA X, distribute it to herself in her individual capacity, and contribute that balance to her rollover IRA.

Taxpayer B, as Trust D Trustee, intends to withdraw the full amount standing in IRA X and then pay said IRA X funds to herself as the named beneficiary of Trust D. Taxpayer B will then contribute the amounts distributed from IRA X to another IRA set up and maintained in her name. The recipient IRA will meet the requirements of Code section 408(a). Said contribution will occur no later than the 60th day following the date on which Taxpayer B, as Trustee of Trust D, receives the IRA X distribution. Both the distribution and contribution will occur in calendar year 2009.

It is represented that Taxpayer B will make "irrevocable" beneficiary designations with respect to the benefits that will be paid from her IRA at her death. The primary beneficiary will be Taxpayer C, if living; or, if not, Taxpayer C's then living descendants, per stirpes. The secondary beneficiary will be the then living nieces and nephews of Decedent A and Taxpayer B, in equal shares.

Based on the above facts and representations, you, through your authorized representative, request the following rulings:

1. That, with respect to Taxpayer B, Decedent A's IRA X will not be treated as an inherited IRA under Code section 408(d)(3)(C);
2. That for purposes of Code section 408(d)(3) and section 1.408-8 of the "Final" Income Tax Regulations (regulations), Taxpayer B may be treated as the beneficiary of Decedent A's IRA X so that the IRA X account balance may be distributed to her and rolled over from Decedent A's IRA X into an IRA set up and maintained in Taxpayer B's name; and
3. That the amounts standing in IRA X which will be distributed to Taxpayer B and then rolled over into an IRA set up and maintained in her name will not be included in her gross income and will not be taxed under Code section 408(d) in the year in which distributed, in which received, and in which rolled over into her IRA. (2009).

With respect to your ruling requests, Code section 408(d)(1) provides that, except as otherwise provided in this subsection, any amount paid or distributed out of an individual retirement plan shall be included in gross income by the payee or distributee, as the case may be, in the manner provided under section 72.

Code section 408(d)(3) provides that section 408(d)(1) does not apply to a rollover contribution if such contribution satisfies the requirements of sections 408(d)(3)(A) and (d)(3)(B).

Code section 408(d)(3)(A)(i) provides that section 408(d)(1) does not apply to any amount paid or distributed out of an IRA to the individual for whose benefit the account is maintained if the entire amount received (including money and any other property) is paid into an IRA (other than an endowment contract) for the benefit of such individual not later than the 60th day after the day on which he receives the payment or distribution.

Code section 408(d)(3)(C)(i) provides, in pertinent part, that, in the case of an inherited IRA, section 408(d)(3) shall not apply to any amount received by an individual from such account (and no amount transferred from such account to another IRA shall be excluded from income by reason of such transfer), and such inherited account shall not be treated as an IRA for purposes of determining whether any other amount is a rollover contribution.

Code section 408(d)(3)(C)(ii) provides that an IRA shall be treated as inherited if the individual for whose benefit the account is maintained acquired such account by reason of the death of another individual, and such individual was not the surviving spouse of such other individual. Thus, pursuant to Code section 408(d)(3)(C)(ii), a surviving spouse who acquires IRA proceeds from and by reason of the death of her husband; may elect to treat those IRA proceeds as her own and roll them over into her own IRA.

Code section 408(d)(3)(E) provides, in general, that the rollover rules of Code section 408(d)(3) do not apply to any amounts required to be distributed in accordance with Code sections 401(a)(9) and 408(a)(6).

Code section 401(a)(9)(A) provides, in relevant part, that distributions from a retirement plan qualified within the meaning of Code section 401(a) must begin no later than the plan participant's "required beginning date" and must be paid over a period of time that may extend to the joint life expectancies of the plan participant and his/her designated beneficiary.

Code section 408(a)(6) extends the Code section 401(a)(9) requirements to IRAs described in Code section 408(a). Thus, in short, an IRA owner may receive required distributions over her life expectancy or over a period not to exceed the joint life expectancies of the IRA holder and her designated beneficiary.

On April 17, 2002, final Income Tax Regulations ("regulations") were published in the Federal Register with respect to Code section 401(a)(9) and 408(a)(6). (See also 2002-19 I.R.B.852, May 13, 2002). Section 1.408-8 of the regulations, Question and Answer 5, provides that a surviving spouse of an IRA owner may elect to treat the spouse's entire interest as a beneficiary in an individual's IRA as the spouse's own IRA. In order to make this election, the spouse must be the sole beneficiary of the IRA and have an unlimited right to withdraw amounts

from the IRA. If a trust is named as beneficiary of the IRA, this requirement is not satisfied even if the spouse is the sole beneficiary of the trust.

The Preamble to the regulations provides, in relevant part, that a surviving spouse who actually receives a distribution from an IRA is permitted to roll that distribution over into his/her own IRA even if the spouse is not the sole beneficiary of the deceased's IRA as long as the rollover is accomplished within the requisite 60 day period. A rollover may be accomplished even if IRA assets pass through either a trust and/or an estate.

With respect to your ruling requests, generally, under certain conditions, if either a decedent's plan or IRA proceeds pass through a third party, e.g., a trust, and then are distributed to the decedent's surviving spouse who is entitled to receive the distribution, said spouse will be treated as acquiring them directly from the decedent. Thus, generally, if the conditions are met, said surviving spouse will be eligible to roll over either the qualified plan or the IRA proceeds into his/her IRA. Generally, for the conditions to be met, the surviving spouse must have total control over the disposition of the plan or IRA assets.

However, prior to addressing the issue of whether Taxpayer B can accomplish her intended rollover, it is necessary to determine whether Taxpayer B has the authority under Trust D and under State W law to withdraw IRA X and distribute it to herself, as proposed. Taxpayer B has taken the position that under certain provisions of Trust D and under State W law, Taxpayer B, as trustee of Trust W, has the authority to withdraw the IRA X balance.

First, Taxpayer B asserts that under Article IV(A) of Trust D, Taxpayer B may withdraw the entire balance of IRA X. Article IV(a) of Trust D provides that Taxpayer B is entitled to as much of the income and, if income is insufficient, as much of the principal as the trustee considers advisable for Taxpayer B's maintenance, support, and health. In this case, Taxpayer B is the trustee. Under State W law, a trustee's power to make discretionary distributions to or for the benefit of the trustee in the trustee's individual capacity is limited by an ascertainable standard relating to the trustee's health, education, support and maintenance as defined in sections 2041 and 2514 of the Internal Revenue Code, to the extent that the trust does not already so provide. STATE W CODE ANN. EST. & TRUSTS section 14-109(a)(1) (West 2009). Accordingly, under Trust D and State W law, Taxpayer B may only make discretionary distributions to herself limited by this ascertainable standard. Taxpayer B admits that she will use her discretionary powers in order to maximize funds available for her maintenance, support, and health, as well as to preserve as much of the principal as possible for the benefit of the remaindermen. Accordingly, we conclude that Taxpayer B, as trustee of Trust D, does not have the authority under Article IV(A) and State W section 14-109(a)(1) to withdraw the entire IRA X balance.

Second, Taxpayer B asserts that, as trustee of Trust D, she is entitled to withdraw the entire balance of IRA X under Article VI(F). Under Article VI(F), the trustee is authorized to "exercise

any other powers which the trustee considers advisable for the proper and advantageous management, investment, and distribution of the property held in Trust.” Taxpayer B asserts that, under State W law, courts have conferred broad discretionary powers on trustees. However, in this case, this provision of Trust D only authorizes Taxpayer B to exercise powers which ensure the proper management and investment and distribution of property held in Trust D. In other words, trust property would continue to be held in Trust D, not entirely withdrawn, as proposed here. Therefore, we conclude that Taxpayer B, as trustee of Trust D, does not have the authority under Article VI(F) to withdraw the IRA X balance.

Third, Taxpayer B asserts that she, as trustee, has the authority to withdraw the entire balance of IRA X, thereby, terminating Trust D, under section 15-114 (the “Prudent Investor Rule”) of the State W Code. This section provides that in making an investment decision, the fiduciary may consider, without limitation, the expected tax consequences of investment decisions or strategies. Taxpayer B elected to have this section apply. However, the prudent investor rule is a rule that allows the fiduciary to consider tax consequences when making investments of trust principal. The rule does not address withdrawals of the principal from a trust. The rule addresses actions to make or retain investments in a trust. Therefore, we conclude that Taxpayer B, as trustee of Trust D, does not have the authority under section 15-114 to withdraw the IRA X balance.

Fourth, under State W law, a court in equity may terminate a trust where termination is not inconsistent with the settlor’s intent or does not defeat a material purpose of the trust and where all of the current and potential beneficiaries (including minor, unborn, or unascertained beneficiaries) consent. Kirkland v. Mercantile-Safe Deposit & Trust Co. of City X, 218 State W. 17 (1958); Probasco v. Clark, 58 State W. App. 683 (State W. Ct. Spec. App. 1984); In re Trust of Lane, 323 State W 188 (1991). However, in this case, Trust D contains a spendthrift provision. It is well settled in State W law that a spendthrift trust cannot be terminated where the interest of one or more beneficiaries is subject to a restraint on alienation, even if all of the possible beneficiaries consent to termination. Kirkland, supra; see also, In re Trust of Lane, supra. In Kirkland, the court stated that spendthrift trusts must be immune from attempts by the beneficiaries themselves to reach the corpus. Kirkland, supra. Therefore, we conclude that the circuit court, Court P, did not have the authority to order that Taxpayer B, as trustee of Trust D, could withdraw the IRA X balance, which in effect terminates Trust D, even if all of the beneficiaries of Trust D consent.

Even though we have concluded that Taxpayer B does not have the authority under Trust D or State W law to withdraw the IRA X balance, Taxpayer B may decide to carry out the Court P order. Therefore, the next issue is whether the circuit court order will be recognized for federal tax purposes. In Commissioner v. Estate of Bosch, 387 U.S. 456 (1967), the Court considered whether a state trial court’s characterization of property rights conclusively binds a federal court or agency in a federal estate tax controversy. The Court concluded that the decision of a state trial court as to an underlying issue of state law should not be controlling when applied to a federal statute. Rather, the highest court of the state is the best authority on the underlying

substantive rule of state law to be applied in the federal matter. If there is no decision by that court, then the federal authority must apply what it finds to be state law after giving "proper regard" to the state trial court's determination and to relevant rulings of other courts of the state. In this respect, the federal agency may be said, in effect, to be sitting as a state court.

In this case, the circuit court order gives Taxpayer B the authority to, in effect, terminate Trust D by withdrawing the entire balance of IRA X and distributing that amount to Taxpayer B. The IRA X distributions to Trust D make up the trust corpus. Without those distributions Trust D would not have any corpus and would, in effect, be terminated. Court P is not the highest court in State W. The highest court in State W, Court Q, has ruled that a spendthrift trust, such as here, cannot be terminated where the interest of one or more beneficiaries is subject to restraint on alienation, even if all of the possible beneficiaries consent to termination. Kirkland, supra. Accordingly, the decision of the Court P is not controlling for purposes of federal tax law. Therefore, we conclude that, after giving proper regard to the circuit court's determination and other State W law, that the circuit court order is not consistent with State W law and, as such, the Service is not bound by the Court P order and any withdrawal by Taxpayer B would be an unauthorized distribution. Further, if, in fact, the beneficiary designation for the rollover IRA may be changed and is not, therefore, irrevocable, and, if, in fact, the remainder beneficiaries did consent to the withdrawal, they may be treated, for federal gift tax purposes, as having made a gift under section 2501.

Finally, Taxpayer B asserts that the Service should rule favorably because she is accomplishing Trust D's purpose. Taxpayer B states that she intends to designate the same individuals named (and in the same order named) as the remainder beneficiaries of Trust D as beneficiaries of her rollover IRA at her death. Taxpayer B claims that the beneficiary designation will be irrevocable. These guarantees, whether irrevocable or not, do not change the fact that Taxpayer B does not have the authority under the trust provisions or State W law to terminate Trust D and, therefore, the Service will not recognize such actions for federal tax purposes.

For the reasons state above, we conclude that Taxpayer B does not have the authority under the provisions of Trust D or State W law to withdraw the entire IRA X balance and that, for federal tax purposes, the Service is not bound by the Court P order.

Thus, in conclusion, Taxpayer B is not entitled to receive a distribution of all amounts remaining in IRA X through Trust D. Thus, under the facts stated above, (except as noted below) Taxpayer B is not to be treated as the payee and beneficiary of IRA X for purposes of Code sections 408(d)(1) and 408(d)(3). Since she is not entitled to receive a distribution of IRA X, and is not the payee or distributee thereof, she is not entitled to contribute as a rollover contribution, IRA X into an IRA set up and maintained in her own name.

Thus, with respect to your ruling requests, we conclude:

1. That (except as noted below) Decedent A's IRA X will be treated as an inherited IRA under Code section 408(d)(3)(C) with respect to the person or entity entitled to receive distributions therefrom (Trust D);

2. That (except as noted below) for purposes of Code section 408(d)(3) and section 1.408-8 of the "Final" Income Tax Regulations, you (Taxpayer B) may not be treated as the beneficiary of Decedent A's IRA X so that the IRA X account balance may not be distributed to you and rolled over from Decedent A's IRA X into an IRA set up and maintained in Taxpayer B's name; and

3. That, amounts standing in IRA X which will be distributed to Taxpayer B (if any) will be taxed under Code section 408(d) in the year in which distributed, in which received.

Please note: The Service's third response (immediately above) concludes that amounts properly paid to Taxpayer B (if any) will be taxed to her in the calendar year received. In this regard, the Service notes that Taxpayer B is entitled, under the provisions of Trust D, to income and principal subject to the standard described therein. Thus, to the extent that Taxpayer B receives distributions consistent with the provisions of Trust D, she will be treated as the payee or distributee, within the meaning of Code section 408(d)(1) thereof.

Furthermore, the Service notes that, under the provisions of Trust D, Taxpayer B has the absolute right to receive distributions of Trust D income. Thus, to the extent Taxpayer B receives a distribution of Trust D income consisting of IRA X assets, she may roll over said distribution to the extent it exceeds amounts required to be distributed from IRA X pursuant to Code section 401(a)(9) made applicable to IRA X pursuant to Code section 408(a)(6) (see Code section 408(d)(3)(E) (above)).

This letter is directed only to the taxpayer who requested it. Code section 6110(k)(3) provides that it may not be used or cited as precedent.

A copy of this letter has been sent to your authorized representative in accordance with a Power of Attorney on file in this office.

If you wish to inquire about this ruling, please contact _____, at
(202) _____ - _____ . Please address all correspondence to SE:T:EP:RA:T3.

Sincerely yours,

A handwritten signature in black ink that reads "Frances V. Sloan". The signature is fluid and cursive, with a long horizontal stroke at the end.

Frances V. Sloan, Manager
Employee Plans Technical Group 3

Enclosures:

Deleted copy of letter ruling
Notice of Intention to Disclose